STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
THE TIDES INN, INC.	:	DETERMINATION
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1978 through August 31, 1986.	:	

Petitioner, The Tides Inn, Inc., 340 Woodcleft Avenue, Freeport, New York 11520, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1978 through August 31, 1986 (File No. 807899).

A hearing was held before Marilyn Mann Faulkner, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on September 13, 1990 at 2:00 P.M. Petitioner appeared by Edwin Sokolow, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Kevin A. Cahill, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation appropriately determined petitioner's tax liability by a percentage markup method.

II. Whether petitioner has established reasonable cause warranting abatement of the penalties imposed.

FINDINGS OF FACT

Petitioner, The Tides Inn, Inc., is a seafood restaurant located on the waterfront in Freeport, New York. The restaurant has an inside and outside bar with a seating capacity of approximately 150 during good weather and the summer months.

A tax auditor for the Division of Taxation sent to petitioner an appointment letter confirming that a field examination of petitioner's sales tax returns would be performed on

March 5, 1987 for the quarterly periods ending February 28, 1979, November 30, 1979, and November 30, 1980 as well as the periods ending August 31, 1983 through February 28, 1987. In this letter, the auditor requested that petitioner have available "all books and records pertaining to your Sales Tax liability for the period under audit...[including] journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records."

The tax auditor found that the records presented during the audit were inadequate. Guest checks, bills, purchase invoices, etc. before 1985 were apparently destroyed by Hurricane Gloria. However, petitioner could not produce sales records for the entire audit period. The auditor noted that there was a discrepancy between the reported sales in the State sales tax returns and the Federal income tax returns for the years ending August 31, 1984 and 1985. Petitioner's accountant explained that the discrepancy resulted because the sales tax returns were estimated whereas the Federal tax returns were based on actual sales for the year. Petitioner made no adjustments to account for the additional State sales tax due.

The auditor determined that the purchase records were adequate for the fiscal years ending August 31, 1984 through August 31, 1986 and that the taxpayer's books and records that accounted for cash purchases, along with bills and cancelled checks, supported the amount of purchases reported on the two Federal income tax returns.[1]

Based on the available purchase records and invoices and the food and liquor prices provided by petitioner's business manager and a 1985 menu, the auditor determined an initial food markup of 157.28%.[2] In making this determination, the auditor took into account

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[1]The auditor reviewed the workpapers attached to the two Federal income tax returns.

[2]From the auditor's worksheets it appears that he had the total purchases for the quarter ending August 31, 1983, but did not have the breakdown between food and liquor purchases. Therefore, he determined the food and liquor breakdown by using the same percentage of liquor purchases to total purchases (12.47%) as was calculated for the year ending in August 31, 1984 and applied that percentage to the total purchases for the August 31, 1983 quarter. Similarly, inasmuch as there apparently were no records with regard to purchases for the quarters ending February 28, 1979, November 30, 1979 and November 30, 1980, the auditor first found the percentage of the

information given to him by the business manager concerning portion sizes and waste with regard to fish and meat servings. Essentially, the auditor calculated the markup by determining the usable portions of the lobster, fish, steak and chicken items based on 100 pounds, then determining the number of servings available from the initial 100 pounds and multiplying that amount by the selling price to determine the total sales.

The auditor made an adjustment to the 157.28% markup on food based on representations by petitioner's accountant that The Tides Inn provided free meals to its employees and engaged in promotional discounts on meals. Apparently, the only evidence offered to support petitioner's claim that meals were discounted was a letter from a radio station saying that it

participated in petitioner's promotional campaign entitled "Adventure in Dining" in which two meals were offered for the price of one. Thus, the auditor decided to apply a 150% markup to both food and liquor.[3] Using this markup, the auditor determined additional sales tax due of $271,537.87.

After further discussions with petitioner's accountant during the audit, the auditor made two more reductions in the food markup. First, the auditor reduced the food markup to approximately 124% to take into account a computation error with regard to lobster costs. The second adjustment concerned the cost of condiments served with the meal, such as potatoes, bread, butter, etc., that were not charged for separately in the cost of the meal. Petitioner's accountant claimed, but presented no evidence to the auditor to support the claim, that the

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sales reported by petitioner in its sales tax returns for the August 31, 1983 quarter to the audited sales (12.35%) and then used that percentage to determine the amount of audited sales for the three quarters.

[3]During the hearing, the auditor testified that markups on liquor generally fall within the range of 200-300% and that he decided it would be equitable, under all the circumstances at that time, to apply the 150% markup to both food and liquor rather than compute separate markups.

additional cost to petitioner for these condiments totalled $2.50 per serving. The auditor allowed one-half of that amount or $1.25 per serving despite the fact that no proof was produced at that time to support the $2.50 condiment claim, and adjusted the markup to 79.36%. Because the food markup was adjusted twice and lowered to 79.36%, the auditor decided to determine a separate markup for liquor based on purchase records, the management's information concerning ounces per drink and menu prices. Accordingly, the auditor calculated the markup for liquor at 217%. Based on the 79.36% food markup and 217% liquor markup, the auditor determined that the total audited

additional sales were $2,387,347.00 resulting in additional tax due of $188,409.95.

On November 16, 1987, the auditor sent to petitioner a letter informing it of the proposed audit adjustment for tax due of $188,409.95. In December of 1987, petitioner's accountant requested the auditor to attend a demonstration at the restaurant to show the amount of waste involved on an individual fish item on the menu. Apparently, the demonstration entailed the cutting of waste from one of the fish items and then weighing the usable portions on a scale. The auditor rejected any further adjustments based on this demonstration noting that the scale was inaccurate and balanced with a one-pound box of sugar.

Prior to closing the case, the auditor made two further adjustments. First, he discovered that petitioner made additional payments of tax for the quarters ending November 30, 1985, February 28, 1986 and August 31, 1986. Accordingly, the tax due was reduced from $188,409.95 to $179,014.32. Secondly, the auditor noted that for the year ending August 31, 1985 petitioner reported sales on its Federal income tax returns that constituted a higher markup (119%) than the audited markup. Therefore, the auditor used the amount of the sales reported on petitioner's Federal income tax returns for the year ending August 31, 1985 and increased the tax due from $179,014.32 to $192,426.02.

The Division sent to petitioner three notices of determination and demands for payment

of sales and use taxes due, dated June 27, 1988.[4] Two of the notices stated total tax due in the respective amounts of $170,890.90 and $21,535.12, plus penalty and interest, for the tax periods in the following amounts:

Period Ending	Tax	Penalty	Interest	
02/28/79		$10,421.88	$2,605.47	$18,580.00
11/30/79		17,579.31	4,394.83	28,505.00
11/30/80		12,933.76	3,233.44	18,203.00
08/31/83		12,317.09	3,079.27	9,512.00
11/30/83		12,713.76	3,178.44	9,155.00
02/28/84		12,713.76	3,178.44	8,517.00
05/31/84		12,713.76	3,178.44	7,885.00
08/31/84		12,713.76	3,178.44	7,271.00
11/30/84		12,798.97	3,199.74	6,727.00
02/28/85		12,467.98	3,117.00	5,999.00
05/31/85		11,933.30	2,983.33	5,215.00
08/31/85		11,917.70	3,575.31	4,698.00
11/30/85		5,653.31	1,695.99	1,996.00
05/31/86		12,012.56	3,603.77	3,298.00
08/31/86		21,535.12	6,460.54	5,095.00

The third notice assessed a $5,111.86 omnibus penalty pursuant to Tax Law § 1145 for the quarters ending August 31, 1985, November 30, 1985, May 31, 1986 and August 31, 1986.

Based upon statements made by petitioner's accountant during the hearing and in its petition, it appears that a conciliation conference was

held and that the conferee sustained the three notices of determination. However, the record does not contain a conciliation order.

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[4]On March 8, 1988, petitioner's accountant signed forms consenting to an extension of the period of limitation for assessment of sales and use taxes until June 20, 1988 for the taxable periods December 1, 1978 through February 28, 1979, September 1, 1979 through November 30, 1979, September 1, 1980 through November 30, 1980 and April 1, 1983 through February 28, 1985. Thus, the notices, dated June 27, 1988, appear to have been issued beyond the limitations periods for assessment of tax for the taxable periods up to and until February 28, 1985. However, neither party raised a statute of limitations issue either in their submissions or at the hearing and, thus, such issue is deemed waived by petitioner (see, Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, 828, lv denied 71 NY2d 806, 530 NYS2d 109; Matter of Convissar v. State Tax Commission, 69 AD2d 929, 415 NYS2d 305, 306; Matter of Servomation v. State Tax Commission, 60 AD2d 374, 400 NYS2d 887; Matter of Jencon, Inc., Tax Appeals Tribunal, December 20, 1990).

By petition dated January 1, 1990, petitioner contended that the tax deficiency was determined "by means of gross margins on particular items sold" and that the conciliation conferee "refused to accept petitioner's submission of evidence relating to costs and sales items."

SUMMARY OF THE PARTIES' POSITIONS

During the hearing, petitioner's accountant argued that, based on evidence he submitted on the hearing date, the food markup should be reduced to 18.5%. Petitioner's accountant also argued that if the food markup were reduced to 18.5%, then the assessment would not be in excess of 25% of the amount of taxes that should have been shown on its tax return and, thus, the $5,111.86 omnibus penalty should be cancelled.

The Division of Taxation argued that petitioner's records were inadequate but that where records were available the auditor used such information to the fullest extent possible; that the auditor gave petitioner the benefit of the doubt in reducing the percentage markup by accepting information concerning free meals to employees and discounted meals without any documentation to support such allegations; that further generous allowances were made for condiments; and that the final food and liquor markups of 79% and 217%, respectively, were substantially lower than that experienced by the auditor and industry standards. The Division noted that the auditor's refusal to further reduce the food markup based on the demonstration of waste on a single fish item was reasonable. Finally, the Division noted that if the food markup were reduced based on the evidence introduced by petitioner's representative during the hearing, then this markup would reflect sales that would be substantially lower than those which were actually recorded on the Federal tax returns.

CONCLUSIONS OF LAW

A. Under Tax Law § 1135(a), "[e]very person required to collect tax shall keep records of every sale...in such form as the commissioner of taxation and finance may by regulation require." These records must be kept in a manner suitable to determine the correct amount of tax due and must be available for the Division's inspection upon request (Tax Law § 1135[d]; 20 NYCRR 533.2[a][2]). The regulations provide that among the sales records required to be maintained are "sales slip, invoice, receipt, contract, statement or other memorandum of sale, ...cash register tape and any other original sales document" (20 NYCRR 533.2[b][1]).

Here, petitioner did not produce any sales slips, cash register tapes or any other original sales document to verify the amount of sales for the period in question. Although petitioner claimed that such documents were destroyed in 1985 by Hurricane Gloria, no other excuse was offered by petitioner for its failure to produce such documents for the audit period after 1985 other than the admission that its records were in "a deplorable state" (Tr. 60).

When the taxpayer's records are incomplete and unreliable for determining accurate sales, the Division may resort to a test-period audit using external indices such as purchases in determining percentage markups (Matter of Skiadas v. State Tax Commission, 95 AD2d 971, 464 NYS2d 304, 305; Matter of Urban Liquors, Inc. v. State Tax Commission, 90 AD2d 576, 456 NYS2d 138, 139; Matter of Hanratty's/732 Amsterdam Tavern, Inc. v. New York State Tax Commission, 88 AD2d 1028, 451 NYS2d 900, 902, lv denied 57 NY2d 608; Matter of Korba v. New York State Tax Commission, 84 AD2d 655, 444 NYS2d 312, 314, lv denied 56 NY2d 502, 450 NYS2d 1023). When conducting the audit, the Division must select a method reasonably calculated to reflect the tax due (Matter of Urban Liquors, Inc. v. State Tax Commission, supra at 139, citing Matter of Grant Co. v. Joseph, 2 NY2d 196, 206, 159 NYS2d 150, cert denied 355 US 869). "[P]etitioners have the burden of demonstrating by clear and convincing evidence that the method of audit or amount of the tax assessed was erroneous" (Id.).

Petitioner has not met its burden of proof in this case. Relying on a 1985 menu and

information provided by petitioner's business manager as to prices, portions and waste per serving, the auditor used the purchase records to determine his initial food markup of 157.28%. The auditor further reduced this markup to 79.36% to reflect free employee meals, promotional discounts, a computational error and the inclusion of condiments accompanying the meal for which there was no separate charge (see Findings of Fact "5", "6" and "7"). In the circumstances of this case, the auditor's selection of the method and the calculation of the markup was reasonable given the information available.

Petitioner argues that the food markup should be further reduced to 18.5% based upon evidence submitted at the hearing with regard to waste and the cost of condiments. Specifically, petitioner presented a chart indicating usable portions of fish and meat items as well as letters from three food suppliers stating the amount of waste involved on certain fish and beef items. However, the usable portions stated in the chart are not consistent in some instances with the letters submitted as support. For example, the chart states that the usable portion of swordfish per 100 pounds is 40 pounds, whereas two different suppliers claim that 80% of the swordfish is usable.[5] Also, one supplier noted that during the height of the molting season, lobster losses could run between 30-35%. In the chart prepared by petitioner, the usable portion was estimated at 70% on lobsters and 80% on lobster tails thereby assuming that all lobsters purchased were at the height of the molting season. Furthermore, there was no support provided for the downward adjustment in petitioner's chart from 70% used by the auditor to 65% with regard to salmon. In any event, no sworn testimony or affidavits were presented to establish the accuracy of the statements made in the suppliers' letters or how these percentages on waste were determined or relate to the particular sales to petitioner. One supplier stated that the percentages were derived from the California Seafood Cookbook by Isaac Cronin; however, no other information was provided to establish whether these percentages represent an industry standard. According to his workpapers, the auditor determined the amount of waste involved

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[5]The auditor used a 65% usable portion for swordfish.

on fish and meat items from information obtained from petitioner's business manager and fish industry guidelines. The letters from suppliers were dated in March 1988, before the notices of determination were issued, yet petitioner claimed that they were not provided to the auditor at that time (Tr. 47). Given the inconsistency of the evidence and uncertainty as to how the standards stated in the suppliers' letters relate to the industry as a whole or to petitioner in particular, petitioner has not met its burden of proof on this issue (see, Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552, 553).

Petitioner also submitted evidence at the hearing purporting to support its contention that the auditor's allowance of $1.25 per serving for condiments served with the meal was low and should have been adjusted to $2.50 per serving. The documents submitted on this issue consisted of a handwritten note in pencil indicating the cost per serving of such condiments as bread, butter, bread sticks, salad and vegetables. Accompanying this breakdown of costs per serving are purchase invoices most of which are dated January and April 1985 concerning such assorted food items as fruits, vegetables, oils, cheese, butter, ketchup, rice, flour, etc. Again, this evidence did not establish how petitioner arrived at the cost per serving nor was any testimony or affidavits presented to establish whether these items were indeed part of the menu or were included with an entree or charged for separately.

The auditor adjusted the food markup from 124% to 79.36% to take into account petitioner's representation that such items were included with the meals (see Finding of Fact "7"). The auditor also took into account petitioner's claims of promotional discounts and that free meals were provided to employees (see Finding of Fact "6"). Petitioner has not presented any evidence to support further downward adjustments to the food markup.[6] The auditor

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[6]As noted by the Division's counsel, it would appear that an 18.5% food markup would be unreasonably low in any event (see, Matter of Zorba Endicott Restaurant Corp., Inc. v. Chu, 126 AD2d 820, 510 NYS2d 315, 316; Matter of Cashelard Restaurant, Inc. v. State Tax Commission, 102 AD2d 984, 477 NYS2d 792; Matter of Skiadas v. State Tax Commission, supra; Matter of Hanratty's/732 Amsterdam Restaurant, Inc. v. New York State Tax Commission, supra at 902; Matter of Korba v. New York State Tax Commission, supra at 314).

utilized what records were available and

information provided by petitioner in a reasonable manner. "Neither exactness in an audit nor an item-by-item analysis is required when petitioner's own faulty record keeping prevents exactness in the determination of the tax liability" (Matter of Day Surgicals, Inc. v. State Tax Commission, 97 AD2d 865, 469 NYS2d 262, 265; see, Matter of Skiadas v. State Tax Commission, supra at 305; Matter of Korba v. New York State Tax Commission, supra at 314; Matter of Convissar v. State Tax Commission, supra).

B. With regard to the penalties imposed, Tax Law § 1145(a)(1)(i) states that any person failing to pay tax to the Tax Commission within the time required by Article 28 "shall" be subject to penalties on the amount of tax due. The Commission will remit all of the penalty if it determines that a taxpayer's failure to pay the tax in a timely manner was due to "reasonable cause and not due to willful neglect" (Tax Law § 1145[a][1][iii]; see, 20 NYCRR 536.5). The taxpayer has the burden of demonstrating that a penalty was improperly assessed (Matter of LT & B Realty Corp. v. New York State Tax Commission, 141 AD2d 185, 535 NYS2d 121, 122).

While there were discrepancies between the amount of sales reported in the State sales tax returns and Federal income tax returns for the same periods, no attempt was made by petitioner to correct those discrepancies. Petitioner offered no excuse for failure to pay the appropriate level of sales tax other than that the business suffered from poor management and that its books and records were in a deplorable state but are in better shape now. Therefore, petitioner has not established any reasonable cause for not paying the appropriate level of sales tax (see, Matter of S.H.B. Supermarkets v. Chu, 135 AD2d 1048, 522 NYS2d 985).

C. Petitioner also argued that if the tax assessed is reduced by the amount requested, then the omnibus penalty would not apply (see Tax Law § 1145[a][1][vi]). Inasmuch as the tax assessed is sustained, this argument is moot.

D. The petition of The Tides Inn, Inc. is denied and the three notices of determination and demands for payment of sales and use taxes due dated June 27, 1988 are sustained.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE